1997

VETERAN RESOURCES INC.

1997 Annual Report

CORPORATE PROFILE

Veteran Resources Inc. is an independent junior oil and gas producer which also provides advanced drilling technology to the oil and gas industry.

Veteran is based in Calgary, Alberta, and is listed on the Alberta Stock Exchange. At year end the Company had issued and outstanding 13.87 million shares (symbol VTI).

Annual and Special General Meeting

The Annual and Special General Meeting of the shareholders of Veteran Resources Inc. will be held in the auditorium Main Floor, Bantrel Tower, 700 – 6th Avenue S.W., Calgary, Alberta on June 25, 1998 at 2:00 pm.

Abbreviations:

MBBL	Thousands of barrels
MMCF	Million cubic feet
BOPD	Barrels of oil per day
BOE	Barrels of oil equivalent 10:1
MBOE	Thousands of BOE's
MMscf/d	Million standard cubic feet per day

TO THE SHAREHOLDERS:

The year 1997 proved to be pivotal for Veteran Resources Inc. ("VTI" or the "Company"). As the year began the Company was working towards finalizing accords for the Russian Project with Joint Stock Company Yukos and the Menatep Bank. Communication and negotiation continued with Joint Stock Company Yukos throughout the year with little progress being made. As the year came to a close the Veteran Board of Directors decided to discontinue all activity related to the Russian Project. This necessitated a write-down of previously capitalized Russian Project costs.

While working on accords for the Russian Project the Company initiated activities on two Western Canadian projects. These ventures targeted sectors of the industry which the Company has determined to be opportunities for application of its advanced drilling technologies.

Water injection was initiated in a pilot waterflood pattern at Provost during the second quarter of 1997. As of year end water injection was continuing, however, no response had been observed at offsetting producers.

A second Bluesky gas test at Red Earth proved to be dry. This well was drilled by an Industry Partner at no cost to the Company. A Precambrian oil test by the same Industry Partner to earn the deep rights was postponed until early 1998. The Company and its Industry Partner have also agreed on a follow up winter drilling program to target the Granite Wash zone. The previously drilled Red Earth Bluesky gas well went on-stream in December.

Veteran continued to provide consulting services to the Industry during 1997.

Early in 1997 the Company completed a private placement of 300,000 units priced at $3.00. Each unit was comprised of one common share and one quarter warrant to purchase a common share at a price of $3.50 for a period of 12 months. At year end the Company completed a flow through share issue of 1,209,668 shares priced at $0.75 per share. Funds from this flow through share issue were to be used to fund the Company's winter drilling program at Red Earth, Alberta scheduled for early 1998.

Management wishes to express its thanks to our shareholders for their continued support and encouragement. Our Board of Directors and employees also deserve sincere appreciation for their dedication.

Donald Jewitt
President

April 20, 1998

The Company initiated a review of opportunities to utilize its expertise in Western Canada while continuing to negotiate and finalize accords for the Russian project. As the year progressed and finalization of any definitive Russian Project agreement became less probable VTI decided to terminate all activity related to the Russian Project. As a consequence of this decision the Company has expensed its previous Russian investment which substantially contributed to the net loss of $1,225,367 recorded for the year.

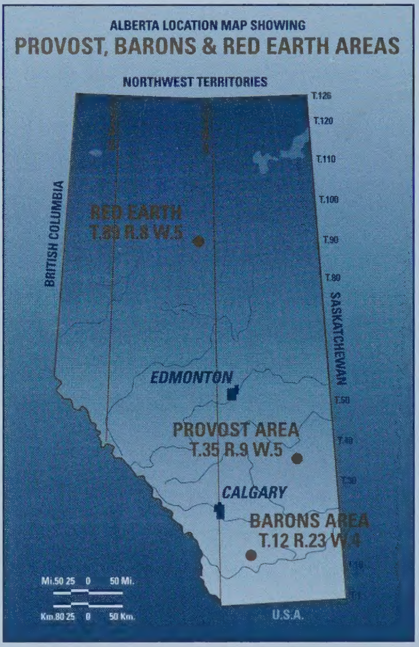
Russian Project

Veteran Resources was unable to bring the Russian Project to fruition in 1997. Considerable negotiation and contract definition were undertaken throughout the year, however, these efforts did not secure an executed agreement and the Company's Board of Directors decided to discontinue all activity related to the Western Siberian venture.

Canadian Activity

Annual average gross Company oil production was 71 BOPD up 6 percent over 1996 production of 67 BOPD. Average crude oil price was $26.45 / bbl down 3 percent from 1996. Crude oil prices began to weaken in the fall of 1997 and contracted significantly by year end. Gas prices remained relatively firm through the year. The Company expects the current weakness in crude oil and strength in natural gas price to continue throughout 1998.

Regulatory approval was obtained to initiate water injection into a pilot waterflood pattern at Provost. A previously drilled horizontal producer was converted to a water injector and injection commenced in the second quarter of 1997. As of year end no detectable response had been recorded at any of the offsetting producing wells. The Company holds a 50 percent working interest in 9,120 gross acres in the Provost area.



An industry partner acquired 3-D seismic data over Veteran's Red Earth acreage during the first quarter of 1997 and drilled a follow-up Bluesky test which was dry and abandoned. This industry partner has committed to drill a Precambrian oil test to earn deep rights on the property by January 31, 1998. Based on the 3-D seismic data, Veteran and its partner have agreed to several follow-up locations to be drilled during the 1997/1998 winter drilling season.

Veteran has the right to participate in these wells at a 40 percent working interest or alternatively may elect to farmout its interest and retain a gross overriding royalty.

The previously drilled Red Earth Bluesky gas well went on stream in December 1997. The Company holds a 15 percent gross overriding royalty on production from this well which will convert to a 40 percent working interest at payout. The Company holds a 40 percent interest in 2,080 gross acres of shallow rights and 100 percent interest in 2,080 gross acres of deep rights in the Red Earth area.

New Ventures

As work on the Russian Project was concluded during 1997 personnel became available to work on other business opportunities. The first of these projects targeted the gas reserves of Northeast British Columbia. The Company believes that, if approved, the Alliance Pipeline Project will finally bring an end to the transportation bottlenecks that have existed to the U.S. After completing detailed technical and feasibility studies of the region the Company selected an area of primary focus and by year end began the task of assembling a land position. The Company has funded this effort 100 percent to its account and will seek a partner for this venture during 1998.

The second of these projects targeted the bitumen/heavy oil reserves of Western Canada. By year end the Company and an industry partner had contracted the Saskatchewan Research Council to conduct laboratory tests on a new insitu recovery process which has been called a "Multi Drain Process". The laboratory work will be carried out during the first half of 1998 and will be used to identify and quantify process variables for the design of a field pilot. The Company expects to use the current weakness in heavy oil price to acquire a land position at minimal carrying cost.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Revenues and Expenses

Gross Revenue in 1997 was $825,114 down $158,000 from 1996 due to reduced consulting revenue. Net consulting income in 1997 was $36,241 down from $73,600 in the prior year.

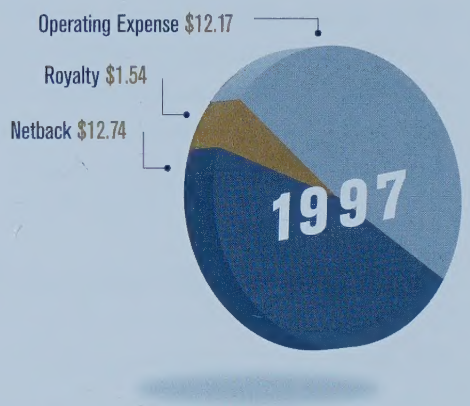
Operating expense in 1997 was $314,769 up $57,510 over 1996 due primarily to one time costs and the pilot injection project at Provost, Alberta.

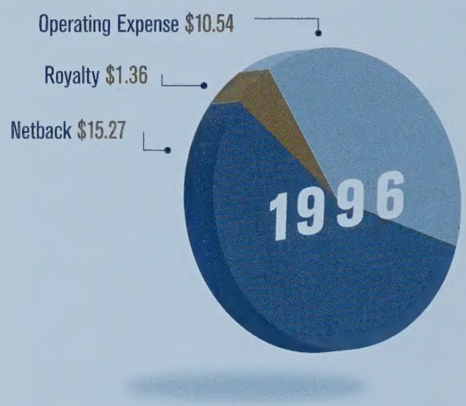
General and administrative expense was $401,640 in 1997 down $53,742 from 1996.

The Company expensed all Russian Project costs of $1,055,872 as a consequence of the decision to discontinue all activity related to the venture.

Operating Netback

Average realized crude oil price during 1997 was $26.45 down $0.72 over 1996. Operating expense increased to $12.17 per barrel in 1997 from $10.54 per barrel in 1996 primarily due to increased costs at Provost. Royalties were up slightly to $1.54 per barrel from $1.36 per barrel in 1996. The operating net back in 1997 was $12.74 per barrel down $2.53 per barrel from 1996. This was largely due to increased operating expenses (64 percent) with reduced oil price contributing 29 percent to the overall reduction.





YEAR 2000 ISSUE

Many computer systems currently record years in a two digit format. Such computer systems will be unable to properly interpret dates beyond the year 1999, which could lead to business disruptions (the "Year 2000 Issue").

The Year 2000 Issue is not considered by management to be material to the Company for either its internal systems or software products and that related costs will not materially affect the financial position or operating results of the Company. However, there can be no assurance that the systems of other companies on which the Company's software products and internal computer systems rely will be timely converted, or a conversion that is incompatible with the Company's software products or internal computer systems, would not have a material adverse effect on the Company.

CANADIAN LAND HOLDINGS

At year end the Company's land holdings were:

	Gross Acres	Net Acres
Provost	9,120	4,560
Barons	480	273
Red Earth	2,080	2,080
TOTAL	**11,680**	**6,913**

RESERVES

The Company's proven and probable oil and natural gas reserves at January 1, 1998 were evaluated by Sproule Associates Limited as shown in the following tables. The Company's gas reserves in the Red Earth area were included as proven producing reserves and have been included in the present values presented in the tables.

Reserves (before royalties)	**1997**	1996
Crude Oil (MBBL)		
Proven	**312.1**	297.8
Probable	**—**	10.9
Total Crude Oil	**312.1**	308.7
Pipeline Gas (MMCF)		
Proven producing	**725.0**	888.0
Total Gas	**725.0**	888.0
Total (MBOE)	**384.6**	397.5

Present Value of Reserves (before tax using escalated prices)

Thousands ($)	Undiscounted	Discounted @ 10%	Discounted @ 15%
Proven	3,846	2,294	1,893
Probable	—	—	—
Sub Total	3,846	2,294	1,893
Alberta Royalty Tax Credit	57	47	43
Total	3,903	2,341	1,936

The value of probable reserves has been reduced by 50% to account for risk.

AUDITORS' REPORT

To the Shareholders of Veteran Resources Inc.:

We have audited the consolidated balance sheet of Veteran Resources Inc. as at December 31, 1997 and the consolidated statements of loss and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1997 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

The consolidated financial statements of Veteran Resources Inc. as at December 31, 1996 and for the year then ended were audited by other Chartered Accountants, whose report dated February 26, 1997, expressed an opinion without reservation on those financial statements.

Arthur Andersen & Co.

Chartered Accountants
Calgary, Alberta

March 26, 1998

MANAGEMENT'S REPORT

The accompanying financial statements and all information in this annual report are the responsibility of management. The financial statements have been prepared by management in accordance with generally accepted accounting principles, and in the opinion of management, present fairly the financial position and results of operations of the Company within acceptable limits of materiality. Financial and operating information presented elsewhere in the annual report is consistent with the results summarized in the financial statements.

Management maintains appropriate systems of internal controls to safeguard assets and enable accurate and timely financial and operational reporting. The accuracy of the financial reporting has been examined by external auditors. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for stewardship and financial reporting and is ultimately responsible for reviewing and approving the financial statements.

Donald Jewitt *President*	Brian Schmidt *Secretary-Treasurer*

CONSOLIDATED BALANCE SHEETS

As at December 31, 1997 and 1996

	1997	1996
ASSETS		
Current Assets:		
Cash and short-term deposits	**$ 570,412**	$ 259,851
Restricted cash (Notes 6 and 10)	**907,250**	—
Accounts receivable	**189,624**	124,801
Prepaid expenses	**24,307**	12,071
	1,691,593	396,723
Investment (Note 3)	**—**	—
Capital assets (Note 4)	**1,187,212**	1,069,797
Deferred expenditures (Note 5)	**—**	964,069
	$ 2,878,805	**$ 2,430,589**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 281,995**	$ 426,200
Provision for site restoration costs	**166,531**	163,976
	448,526	590,176
Shareholders' equity:		
Capital stock (Notes 6 and 10)	**5,812,930**	3,997,697
Deficit	**(3,382,651)**	(2,157,284)
	2,430,279	1,840,413
	$ 2,878,805	$ 2,430,589

On behalf of the board

Director

Director

The accompanying notes are an integral part of these consolidated balance sheets.

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

For the Years Ended December 31, 1997 and 1996

	1997	1996
Revenue		
Oil and gas	$ 673,060	$ 663,190
Royalties	(39,718)	(33,261)
Net production revenue	633,342	629,929
Consulting	173,217	346,630
Interest	18,555	6,660
	825,114	983,219
Expenses		
Operating	$ 314,769	$ 257,259
General and administrative	401,640	455,382
Consulting	136,976	273,030
Depletion and depreciation	138,669	153,556
Site restoration	2,555	15,700
Write-down of investment (Note 5)	1,055,872	—
	2,050,481	1,154,927
Loss	(1,225,367)	(171,708)
Deficit—beginning of year	(2,157,284)	(1,985,576)
Deficit—end of year	$ (3,382,651)	$ (2,157,284)
Loss per share	$ (0.10)	$ (0.01)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the Years Ended December 31, 1997 and 1996

	1997	1996
Operating activities:		
Loss	$ (1,225,367)	$ (171,708)
Items not affecting cash—		
Depletion and depreciation	138,669	153,556
Site restoration	2,555	15,700
Write-down of investment (Note 5)	1,055,872	—
Funds used in operations	(28,271)	(2,452)
Net change in non-cash working capital	(221,264)	(98,886)
	(249,535)	(101,338)
Financing activities:		
Issue of common shares	1,815,233	32,501
Investing activities:		
Purchase of capital assets	(256,084)	(102,232)
Deferred expenditures	(91,803)	(257,238)
	(347,887)	(359,470)
Increase (decrease) in cash for the year	1,217,811	(428,307)
Cash—beginning of year	259,851	688,158
Cash—end of year	$ 1,477,662	$ 259,851
Funds used in operations per share	$ —	$ —
Cash is comprised of:		
Cash and short-term deposits	$ 570,412	$ 259,851
Restricted cash	907,250	—
	$ 1,477,662	$ 259,851

The accompanying notes are an integral part of these consolidated financial statements.

1. Company Operations

Veteran Resources Inc. ("the Company") is engaged in the acquisition of, exploration for and development of oil and natural gas properties in Canada. In addition, the Company has developed a horizontal drilling technology which it makes available to the industry on a fee basis or for participating interests and which it expects to apply to the development of its own oil and gas properties.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary Veteran Resources Offshore (Cyprus) Limited. All significant intercompany transactions and balances have been eliminated on consolidation.

2. Summary of Significant Accounting Policies

Capital Assets

The Company follows the full cost method of accounting for its petroleum and natural gas properties and equipment whereby all costs, net of incentives, related to the exploration for and development of oil and gas reserves are capitalized. Costs include lease acquisition, geological and geophysical expenditures, carrying costs of non-productive properties, the drilling of productive and non-productive wells and related plant and production equipment costs. Proceeds on disposal of properties are ordinarily deducted from such costs without recognition of profit or loss except where such disposal would change the rate of depletion by 20% or more.

The Company calculates a "cost ceiling" which limits the net book value of capital assets to the undiscounted and unescalated estimated future net revenues from production of proved reserves based upon period-end prices. Additional depletion is provided if the net book value of capitalized costs exceeds such future revenue. This test also accounts for general and administrative expenses, future site restorations and abandonments, financing costs and income taxes, all undiscounted and unescalated.

Depletion is computed using the unit-of-production method where the ratio of production to proved reserves, before royalties, determines the proportion of depletable costs to be expensed. Depletable costs are reduced by estimated future salvage values from wells, plants and facilities, and undeveloped properties are excluded from the depletion calculation until the quantities of proved reserves can be determined.

Costs relating to the construction and development of drilling equipment are deferred until completion of the project. These costs will be depreciated over future periods on a basis

not to exceed the useful life of the equipment. Where there is a significant degree of uncertainty as to whether sufficient revenue will be generated from the equipment, the unrecoverable costs are expensed.

Depreciation on drilling equipment and office equipment is computed on the declining balance method at the rate of 30% and 20% respectively per year.

Future site restoration costs

The provision for future site restoration costs relating to petroleum and natural gas properties, as estimated by the Company, is charged against income on a unit-of-production basis. The cumulative amount, net of actual expenditures, is recorded as provision for site restoration costs.

Income taxes

The Company uses the deferral method of income tax allocation. Income taxes are provided at current rates for all items included in the statement of income regardless of the period when such items are reported for income tax purposes. The principal items which result in timing differences for financial and tax reporting purposes arise from claiming capital cost allowance and exploration and development expenses in excess of depreciation and depletion charged against income.

Joint ventures

A significant portion of the Company's exploration, development and production activities are conducted jointly with other entities and accordingly these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Per share information

Per share information is based on weighted average number of shares outstanding during the period, which was 12,618,886 (1996—12,292,839). Fully diluted earnings per share and cash flow per share, as affected by stock options as described in Note 6, is anti-dilutive.

3. Investment

On March 10, 1995, the Company received 1,000,000 shares of Airgen Corporation ("Airgen") for a nominal amount as compensation for providing bridge financing to Airgen in 1995. At December 31, 1995 these shares were not quoted. During 1996 Airgen obtained a listing on the Alberta Stock Exchange. On December 31, 1997 the shares closed at $0.65 (1996—$0.43).

4. Capital Assets

	1997		1996	
	Cost	**Accumulated Depletion and Depreciation**	Cost	Accumulated Depletion and Depreciation
Petroleum and natural gas properties	**$ 2,381,514**	**$ 1,393,413**	$ 2,136,253	$ 1,329,448
Drilling equipment	**427,154**	**277,288**	427,154	213,543
Office equipment	**86,276**	**37,031**	75,453	26,072
	$ 2,894,944	**$ 1,707,732**	$ 2,638,860	$ 1,569,063
Net book value	**$ 1,187,212**		$ 1,069,797	

5. Deferred Expenditures

The company incurred costs of $1,055,872 (1996—$964,069) relating to the establishment of a joint stock company in Russia with a Russian joint venture partner. Costs incurred included travel, business promotion, professional fees, salaries and management fees charged by directors of the Company. The project was terminated during 1997 and accordingly all costs associated with the project have been charged to income.

6. Capital Stock

Authorized—

Unlimited number of common shares without nominal or par value

Unlimited number of redeemable preferred shares

Issued—common shares

	1997		1996	
	Number of shares	**$**	Number of shares	$
Balance—beginning of year	**12,333,169**	**3,997,697**	12,260,101	3,961,162
Issued for cash				
(net of issue costs of $5,112)	**300,000**	**894,888**	—	—
Issued pursuant to				
exercise of stock options	**29,266**	**14,632**	73,068	36,535
Flow-through shares issued for cash				
(net of issue costs of $1,537)	**1,209,668**	**905,713**	—	—
Balance—end of year	**13,872,103**	**5,812,930**	12,333,169	3,997,697

Stock options and warrants

Stock options have been granted to directors, officers, employees and consultants entitling them to purchase common shares of the Company. At December 31, 1997, options to purchase 712,665 (1996—741,931) common shares were outstanding as follows:

Number of Options	Exercise Price	Expiry Date
677,665	$ 0.50	August 5, 1998
35,000	$ 3.15	January 28, 1999

At December 31, 1997, 75,000 warrants were outstanding. Each warrant entitles the holder to purchase one common share at a price of $3.50 per share. The warrants expired in February 1998.

Flow-through shares

Under this type of financing arrangement, shares are issued at a fixed price and the resultant proceeds are used to fund exploration and development work within a defined time period. The tax deductions arising are available to the investors, not the Company. The paid up amount for flow-through shares and the cost of oil and gas properties will be reduced by the estimated amount of tax benefits renounced to the purchaser of the shares, when the qualifying expenditures are incurred.

7. Income Taxes

The provision for income taxes reflects an effective tax rate which differs from the expected Canadian income tax rate of 44.62% as summarized below:

	1997	1996
	$	$
Statutory income tax rates	**44.62 %**	44.62 %
Expected provision for income taxes	**(546,759)**	(86,094)
Non-deductible crown payments	**17,722**	20,710
Resource allowance	**(27,962)**	(15,397)
Future tax benefit not recognized	**555,626**	89,136
Other	**1,373**	(8,355)
Income taxes	**—**	—

The Company has an excess of accumulated tax pools over the net book value of capital assets of approximately $1,564,000 (1996–$1,425,000). These tax pool balances are available to reduce future taxable income.

The Company has non-capital losses of approximately $1,726,000 (1996—$1,530,000). These losses may be used to reduce future taxable income and will begin to expire in the year 2000. The future benefit of these losses have not been recognized in these financial statements.

8. Segmented Information

December 31, 1997	Oil & Gas $	Consulting $	Corporate $	Total $
Revenue	**633,342**	**173,217**	**18,555**	**825,114**
Depletion and Depreciation	**63,965**	**63,745**	**10,959**	**138,669**
Earnings (Loss) Before Income Taxes	**133,695**	**(68,913)**	**(1,290,149)**	**(1,225,367)**
Identifiable Assets	**2,064,456**	**178,069**	**636,280**	**2,878,805**

December 31, 1996	Oil & Gas $	Consulting $	Corporate $	Total $
Revenue	629,929	346,630	6,660	983,219
Depletion and Depreciation	52,036	92,850	8,670	153,556
Earnings (Loss) Before Income Taxes	168,318	(19,250)	(320,776)	(171,708)
Identifiable Assets	910,343	245,654	1,274,592	2,430,589

9. Financial instruments

Financial instruments recognized on the balance sheet consist of cash and short-term deposits, accounts receivable and accounts payable and accrued liabilities. The fair value of these financial instruments, as at December 31, 1997 and 1996, approximates their carrying value due to the short term maturity of these instruments .

10. Restricted cash

Restricted cash represents proceeds from the flow-through share offering which has not been spent on qualifying expenditures as at December 31, 1997.

11. Events subsequent to December 31, 1997

Subsequent to year end, the Company received a short-term loan to finance land purchases, in the amount of $300,000.00 from a corporation controlled by an officer and director of the Company. The loan is unsecured and non-interest bearing and has no fixed terms of repayment.

CORPORATE INFORMATION

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Vice President Exploration
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Del Roca Energy Inc.

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BANKERS
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